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Supreme Court of the United States.

October Term, 1931.

No. 714

WALTER J. MacDONALD, Trustee in Bankruptcy of Craig, Reed & Emerson, Inc.,
Petitioner Herein,

v.

PLYMOUTH COUNTY TRUST COMPANY,
Respondent Herein.

In the Matter of
Craig, Reed & Emerson, Inc., Bankrupt.

Petition for Writ of Certiorari to Issue to the United States Circuit Court of Appeals for the First Circuit and Brief in Support Thereof.

ROBERT A. B. COOK,
Attorney for Petitioner.

ADDISON C. GETCHELL & SON, LAW PRINTERS, BOSTON.

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Supreme Court of the United States.

OCTOBER TERM, 1931.

No.

WALTER J. MACDONALD, TRUSTEE IN BANKRUPTCY OF CRAIG, REED & EMERSON, INC.,

Petitioner herein,

v.

PLYMOUTH COUNTY TRUST COMPANY,

Respondent herein.

IN THE MATTER OF

CRAIG, REED & EMERSON, INC., BANKRUPT.

NOTICE.

The respondent is hereby notified that the enclosed petition for a writ of certiorari to the United States Circuit Court of Appeals for the First Circuit, and the annexed brief in support thereof, will be submitted to the Supreme Court of the United States on the first motion day after the expiration of two weeks from the date of the filing thereof, as provided by the rules of said court.

ROBERT A. B. COOK,

Attorney for Petitioner.

Dated February 15, 1932.

Supreme Court of the United States.

OCTOBER TERM, 1931.

No.

WALTER J. MACDONALD, TRUSTEE IN BANKRUPTCY OF CRAIG, REED & EMERSON, INC.,

Petitioner herein,

v.

PLYMOUTH COUNTY TRUST COMPANY,

Respondent herein.

IN THE MATTER OF

CRAIG, REED & EMERSON, INC., BANKRUPT.

PETITION FOR WRIT OF CERTIORARI TO ISSUE TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

To the Honorable the Chief Justice of the Supreme Court of the United States and the Honorable Associate Justices thereof:

The petitioner, Walter J. MacDonald, as he is the Trustee in Bankruptcy of Craig, Reed & Emerson, Inc., respectfully represents and shows to this Honorable Court as follows:

1. On or about July 16, 1929, and at the request and instance of the respondent herein, and after the transactions hereinafter complained of, Craig, Reed & Emerson, Inc., made and executed a general assignment for the benefit of creditors unto one Loring H. Hall, an officer of the respondent company. Thereafter, and on the 28th day of September, 1929, a creditors' petition in bankruptcy was filed against the said Craig, Reed & Emerson, Inc., in the District Court of the United States for the District of Massachusetts, and upon such petition an adjudication was had. Thereafter, and on the 27th day of November, 1929, your petitioner was elected trustee in bankruptcy, and at once qualified as such trustee.

2. For several years and more prior to its bankruptcy, Craig, Reed & Emerson, Inc., hereinafter referred to, for brevity, as the "company," had been indebted to the respondent in a substantial amount. For twenty-eight months next prior to its bankruptcy the company had made no payment to the respondent on account of such indebtedness, which, throughout the said period, was represented by a demand note. The respondent during that entire period regarded the indebtedness as a "frozen loan"; and it regarded the company as "insolvent."

In June of 1929—a matter of three weeks before the assignment hereinbefore referred to—a meeting of the company's stockholders was held. The only person present or represented at that meeting other than stockholders was the respondent, who was represented by its president. The purpose of the meeting was to determine how the business of the company could be carried along with the least possible loss. An extension was then asked of the respondent. At the hearing before the referee conflicting testimony was given with respect to whether the respondent had assented to the extension there asked. The referee, before whom the case was heard, found that the respondent had agreed to such extension.

The principal outlet for the company's products was a chain of retail shoe stores. These stores paid their bills once a month and about the middle of each month, a fact known to the respondent and so found by the referee. On July 10, 1929, or thereabouts, the respondent, by its officers, caused the following notation to be made on one of the cards upon which the respondent kept a record of its dealings with the company: "Show all checks and deposits to Mr. Crocker." Crocker was a vice-president of the respondent. These directions were carefully followed, as the evidence showed.

Late in the afternoon of July 11, 1929, the company deposited with the respondent certain checks aggregating $15,100.78 which it had received from said chain of retail stores. At the time such deposit was made, the company had to its credit with the respondent a balance of $5140.87, all of which represented funds deposited by the company with the respondent from and after the time of the stockholders' meeting held in June, 1929, or three weeks before such deposit was made. Of the balance then to the credit of the company $4027.29 represented collected funds and the remainder uncollected funds.

On the morning of July 12th, the respondent appropriated on account of its indebtedness the collected funds of $4027.29. At that time the respondent had not called the company's demand loan, nor had it told the company of what it was doing or contemplated doing. The deposit of $15,100.78 was not credited to the company's balance at the time it was made, but was sent with a special letter to the respondent's correspondent bank in New York City for collection, with the request that it wire the respondent when collection was made. The respondent intended to apply this deposit if collected, but was not going to grant credit therefor to the company until it could be certain that the checks had been paid. Otherwise, according to the testimony of one of the officers, the respondent "would have been out of luck."

On Saturday, July 13th, not hearing from the correspondent bank as early as it desired, the respondent telegraphed it inquiring to know the fate of these checks, and a little later in the day one of the officers addressed a letter to the correspondent bank expressing regret at the latter's failure to report. Copies of these communications are to be found in the record, page 100. Later, and on July 13th, the respondent heard favorably from its correspondent, and thereupon the deposit was appropriated. This deposit was never credited to the company's balance, but was entered on the respondent's ledger card as a "wash" transaction on July 13, 1929, or thereafter (see Exhibit 6, Rec. p. 103).

On July 13, 1929, the respondent addressed a letter to the company informing it that its loan was called. Even then the company was not advised of the appropriations by the respondent (Rec. p. 105). This communication was not received by the company until July 17th or thereabouts. On July 15th, however, the respondent, by one of its officers, called the company by telephone and made known to it that it had called the loan and had appropriated the company's bank balance; and, moreover, had by its own counsel prepared an assignment for the benefit of creditors which it was calling upon the company to execute. The officers of the company protested the acts of the respondent. Finding that they could not prevail upon the respondent to undo what it had done, and knowing that it could not go on in business without the funds so appropriated by the respondent, the company executed the assignment planned and prepared by the respondent and its counsel. A sale of the assets of the company was thereafter made by the assignee, and within a day or two following the time of such sale, and on the 28th day of September, 1929, a creditors' petition in bankruptcy was filed, and upon this petition the company was duly adjudicated bankrupt and the petitioner herein was elected trustee. The officer of the respondent who was serving in the capacity of assignee surrendered and de-

livered to the petitioner the funds in his possession derived from the sale of the company's assets, but he and his principal, the respondent, refused to surrender and deliver unto the petitioner as trustee the funds that the respondent had appropriated and amounting in the aggregate to $20,476.79 and comprising appropriations made on July 12th, 13th and 15th. Upon such refusal, the petitioner filed a bill in equity with the referee in bankruptcy, having charge of the administration of the company's affairs, to recover from the respondent the funds so preferentially received by it. The respondent formally consented to the jurisdiction of the referee, and the cause was thereupon heard at length on merits before such referee. The referee made a finding against the respondent, who thereupon took a review to the District Judge.

At the hearing before the latter, and for the first time and notwithstanding its formal consent and its engaging in a hearing on merits before the referee, the respondent questioned the jurisdiction of the referee. The District Judge overruled this contention of the respondent, and, after arguments on both the facts and the law, and after consideration thereof, entered a decree in favor of the petitioner herein. From this decree an appeal was taken to the Circuit Court of Appeals for the First Circuit, and that court, without in any wise passing upon the merits, held in substance that, irrespective of the respondent's formal consent and irrespective of its going to trial on merits before the referee and its peculiar relation to the assets of the estate, the referee was without jurisdiction to hear the suit, and that jurisdiction could not be conferred upon him.

3. This decision appears to be in direct conflict with the decisions of this court rendered in the following cases:

Harrison, Trustee, v. *Chamberlain,* 271 U.S. 191;
Taubel Scott v. *Fox,* 264 U.S. 426;
May v. *Henderson,* 268 U.S. 111—

and is in direct conflict with—

In re Clarence A. Hopkins (C.C.A. 2), 229 Fed. 378 (certiorari denied, 241 U.S. 669).

American Finance Co. v. *Coppard* (C.C.A. 5), 45 Fed. (2d) 154.

Board of Education of Salt Lake City v. *Leary* (C.C.A. 8), 236 Fed. 521.

Gamble v. *Daniel* (C.C.A. 8), 39 Fed. (2d) 447.

Page, Trustee, v. *Arkansas National Gas Corp.* (C.C.A. 8, decided October 5, 1931), 53 Fed. (2d) 27.

Moreover, the decision in the instant case cannot be harmonized with that rendered by the same court (C.C.A. 1) in the case of *Foster* v. *Manufacturers Finance Co.*, 22 Fed. (2d) 609 (certiorari denied, 276 U.S. 633). In the latter case the Finance Company consented to jurisdiction. Nevertheless, the referee in bankruptcy, who heard the alleged preference suit himself, raised the question of jurisdiction. Such question as raised by him was an outstanding part of the record which was before the Appellate Court. While jurisdiction was acquiesced in by the respondent in that case, nevertheless, the court's attention was directed to the issue as raised by the referee and, without adverting to the jurisdictional question, the Appellate Court disposed of the case on its merits.

4. This decision of the Circuit Court of Appeals for the First Circuit produces a contrariety of decisions by Circuit Courts of Appeal and tends to create a misinterpretation and misunderstanding of the decisions of this court, and in consequence it is of great public interest and essential to the proper and orderly administration of the bankruptcy law that this case be reviewed by this court and the final and definite rule of law upon the questions herein involved, and especially the jurisdictional question, be laid down.

5. The interpretations by the lower courts of the decisions of this court bearing upon the jurisdictional question here involved are so utterly irreconcilable that they have served to create doubt as to the meaning and intendment of the principles heretofore enunciated by this court.

6. The merits of this case also involve a question of great public interest; hence it is desirable that they, too, be heard and determined so far as the same may be desirable in this proceeding.

The petitioner further respectfully submits that this petition should be allowed on the grounds stated and for the following specific reasons:

I. The decision of the said Circuit Court of Appeals for the First Circuit is in conflict with the decisions of the Circuit Courts of Appeals for the Second, Fifth and Eighth Circuits, and undoubtedly misconstrues and misinterprets the decisions of this court, and cannot be reconciled with one of its own earlier decisions; hence it is desirable that the rule of law applicable thereto be definitely and finally established by this court.

II. The interpretations by the lower courts of the decisions of this court bearing upon the jurisdictional question here involved are so utterly irreconcilable that they have served to create doubt as to the meaning and intendment of the principles heretofore enunciated by this court; hence it is desirable that the rule of law applicable thereto be definitely and finally established by this court.

III. The merits of the case present a question of great public interest; hence the supervision of this court should be exercised to the end that the rule of law applicable thereto shall be established.

Wherefore the petitioner respectfully prays—

That a writ of certiorari may be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the First Circuit, commanding said court to certify and send to this court a

full and complete transcript of the record and of all of the proceedings in this cause, to the end that said cause may be reviewed as determined by this court, as provided by law; and that it may have such other and further relief as to this Honorable Court may seem appropriate and in conformity with law.

ROBERT A. B. COOK,
Attorney for Petitioner.

I hereby certify that I am of counsel for the petitioner herein, Walter J. MacDonald, Trustee, and that in accordance with the request of said petitioner the foregoing petition has been prepared, and that the allegations contained in said petition are true to the best of my knowledge and belief; and that said petition, in my opinion, is well founded in law and in fact and should be granted.

ROBERT A. B. COOK.

COMMONWEALTH OF MASSACHUSETTS.

SUFFOLK, ss. BOSTON, February 15, 1932.

Then personally appeared Robert A. B. Cook of Wellesley, Massachusetts, and made oath that he prepared and signed the foregoing petition and that the same is prepared with the consent of and in accordance with the request of the petitioner named therein, and that the allegations contained in said petition are true to the best of his knowledge and belief.

Before me,
MARVIN C. TAYLOR,
Notary Public.

My commission expires Dec. 21, 1934.

Supreme Court of the United States.

OCTOBER TERM, 1931.

No.

WALTER J. MacDONALD, TRUSTEE IN BANRUPTCY OF CRAIG, REED & EMERSON, INC.,

Petitioner herein,

v.

PLYMOUTH COUNTY TRUST COMPANY,

Respondent herein.

IN THE MATTER OF

CRAIG, REED & EMERSON, INC., BANKRUPT.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

STATEMENT OF THE CASE.

The proceedings in this case are shown in full in the record and described, we believe, in sufficient detail in the petition herewith (Petition, pp. 3-10). The assets of the bankrupt were at the time of the filing of the petition against it, and at the time of the adjudication and the election of the petitioner as trustee, in the hands of an officer and agent of the respondent herein purporting to act as a common-law

assignee for the benefit of creditors. The bill of complaint filed with the referee was plenary in its character and the case was heard on its merits according to the rules then prevailing in the District Court of the United States for the District of Massachusetts governing the admission and exclusion of evidence. The respondent, by its counsel, in open court, and in the presence of the president, vice-president and other authorized officers of the respondent company, formally consented to the jurisdiction of the court (Rec. pp. 24, 25).

ARGUMENT.

(*I*) *The decision of the said Circuit Court of Appeals for the First Circuit is in conflict with the decisions of the Circuit Courts of Appeals for the Second, Fifth and Eighth Circuits, and undoubtedly misconstrues and misinterprets the decisions of this court, and cannot be reconciled with one of its own earlier decisions; hence it is desirable that the rule of law applicable thereto be definitely and finally established by this court.*

(*II*) *The interpretations by the lower courts of the decisions of this court bearing upon the jurisdictional question here involved are so utterly irreconcilable that they have served to create doubt as to the meaning and intendment of the principles heretofore enunciated by this court; hence it is desirable that the rule of law applicable thereto be definitely and finally established by this court.*

It will be well first to consider the organic law. Under the caption "Jurisdiction of United States and State Courts," section 23 (*b*) of the Bankruptcy Act, as it was originally enacted, provided as follows: "Suits by the trustee shall be brought or prosecuted only in the courts where the bankrupt, whose estate is being administered by such trustee, might have brought or prosecuted them if proceedings in bankruptcy had not been instituted, unless by consent of the pro-

posed defendant." And, thereafter, in 1903, and again in 1910, Congress enacted certain amendments to the law for the purpose of giving greater definiteness to various of its provisions and for the enlargement of the scope of the law. To section 23 (*b*) were added the following words: "except suits for the recovery of property under Section 60, subdivision b; section sixty-seven, subdivision e; and section seventy, subdivision e." And to section 60 (*b*), under the caption "Preferred Creditors," and having to do with the recovery of property preferentially transferred, there was added by way of amendment the following: "And for the purpose of such recovery any court of bankruptcy, as hereinbefore defined, and any state court which would have had jurisdiction if bankruptcy had not intervened, shall have concurrent jurisdiction." There have been no material changes since made in these sections.

When we pause and consider these amendments, it becomes convincingly clear that it was the intention of Congress that courts having to do with the administration of bankruptcy cases should, so far as might be practicable, be vested with jurisdiction over all matters arising in such cases. Prior to the amendments of 1903 and 1910 there was but one class of cases which a trustee in bankruptcy could, as a matter of right under section 23 (*b*), institute in courts administering bankruptcy; and, with these amendments, another class was added. But at all times, both before 1903 and since, such courts have always, and with the consent of the proposed defendant, had jurisdiction over all matters and controversies arising in bankruptcy.

Jurisdiction by consent is in no wise limited or restricted by the amendment of 1903 made to section 60 (*b*). That amendment was merely to conform with the amendment to section 23 (*b*), which latter section was being enlarged in its scope and operation. Congress did not by these amendments disturb the consent provision of section 23 (*b*). Nevertheless, the Circuit Court of Appeals for the First

Circuit, in utter disregard of the provisions of section 23 (*b*) and of its own action in the case of *Foster* v. *Manufacturers Finance Company,* 22 Fed. (2d) 609 (certiorari denied, 276 U.S. 633), wherein the record disclosed that the referee had himself there raised the question of jurisdiction and had decided that by virtue of the consent of the parties, and particularly the consent of the proposed defendant, he was vested with jurisdiction, yet, in the instant case, held that the court before whom this case was initiated or instituted was without the requisite jurisdiction to hear the cause and the decree of the court below was reversed without apparently any consideration of the merits of the case.

It will be observed that these proceedings were begun by a bill in equity, plenary in its character. The case was tried and heard, according to the rules obtaining in the Federal courts with respect to the admission and exclusion of evidence. The proposed defendant had consented to jurisdiction, and it was only after the defendant had fully tried its case and lost that the question of jurisdiction was raised, and that, too, notwithstanding the fact that this question was considered at the very start of the trial and the jurisdictional issue was waived by the proposed defendant, who, through its counsel, in open court and in the presence of authorized officers and agents of the defendant trust company, consented to such jurisdiction. The counsel who then appeared for the defendant are now appearing for it. For this unconscionable breach of agreement, and breach of faith with the court below, the Circuit Court of Appeals for the First Circuit rewards the defendant not only with a reversal of the decree in the court below, but, moreover, allows the defendant costs in connection with its appeal.

So far as the instant case is before this court on the jurisdictional question, that question, when reduced to its simplest proportions, may be thus stated: May a referee in bankruptcy, by and with the consent of the proposed defendant, lawfully hear a petition or bill of complaint for the re-

covery of property under section 60 (*b*) of the Bankruptcy Act.

In the case of *Harrison* v. *Chamberlain*, 271 U.S. 191, 193, 194, the facts were as follows:

Upon a petition by the trustee in bankruptcy for a summary order requiring the respondent to deliver to the trustee certain money in her possession, a demurrer was filed. The matter was referred by the District Judge to the referee in bankruptcy to report his findings of fact and conclusions of law. The referee's report was confirmed, and from the decree of the District Judge an appeal was taken. Whether the case should have gone up on appeal or on petition to revise was also considered. This court in its opinion, at page 193, said: "It is well settled that a court of bankruptcy is without jurisdiction to adjudicate in a summary proceeding a controversy in reference to property held adversely to the bankrupt estate, *without the consent of the adverse claimant* [italics ours]; but resort must be had by the trustee to a plenary suit." And, at page 194: "However, the court is not ousted of its jurisdiction by the mere assertion of an adverse claim; but, having the power in the first instance to determine whether it has jurisdiction to proceed, the court may enter upon a preliminary inquiry to determine whether the adverse claim is real and substantial or merely colorable. And if found to be merely colorable the court may then proceed to adjudicate the merits summarily; but if found to be real and substantial it must decline to determine the merits and dismiss the summary proceeding." In conclusion, and at page 195, this court further said: "As the respondent's objection to the summary jurisdiction of the bankruptcy court was well taken, *and there was no waiver of her right in this respect* [italics ours], Galbraith v. Vallely, supra, 50, the decree of the Circuit Court of Appeals is affirmed."

In the case of *Taubel-Scott-Kitzmiller Company, Inc.*, v. *Fox*, 264 U.S. 426, an order was issued by a referee in bankruptcy to a creditor to show cause why his execution

should not be declared void and the property surrendered to the trustee. The claimant seasonably challenged the court's jurisdiction. At pages 433 and 434 this court said: "Wherever the bankruptcy court had possession, it could, under the Act of 1898, as originally enacted, and can now, determine in a summary proceeding controversies involving substantial adverse claims of title under subdivision (e) of Section 67, under subdivision (b) of Section 60 and under subdivision (e) of Section 70. But in no case where it lacked possession, could the bankruptcy court, under the law as originally enacted, nor can it now (without consent) adjudicate in a summary proceeding the validity of a substantial adverse claim."

The case of *May* v. *Henderson,* 268 U.S. 111, is to like effect.

By other Circuit Courts of Appeals we have the following contra-decisions:

In re Hopkins (C.C.A. 2), 229 Fed. 378, at page 380: "The question was presented to the Trustee whether he would proceed summarily or by plenary suit and he elected the former without objection by the bankrupt, his wife or any one else. Having proceeded without objection, we think it is too late now to present a question which is addressed solely to the form of the proceeding. If the objection had been made at the time the Trustee was required to elect, it is quite possible that the petitioner's contention would have been sustained. But she, apparently, acquiesced in the summary proceedings as the most satisfactory way of disposing of the question and we are of the opinion that it is too late to present the question on this review by an Appellate Court."

In *Whitney* v. *Barrett* (C.C.A. 5), 28 Fed. (2d) 760, at page 761: "This was a summary proceeding. In such a proceeding the bankruptcy court is without jurisdiction to determine a controversy in reference to property adversely held without the consent of the adverse claimant."

In re Rochford (C.C.A. 8, Sanborn, Thayer, Van Devanter, JJ.), 124 Fed. 182, at page 186: "The district court sitting in bankruptcy has no jurisdiction over a controversy between the trustees in bankruptcy and the adverse claimant over the title or possession of property in the custody of the latter and in the absence of his consent." In this case the proceedings arose before a referee in bankruptcy, and the referee was the court of first instance.

In the case of *Board of Education of Salt Lake City* v. *Leary* (C.C.A. 8), 236 Fed. 521, the court there likewise held that the lower court could proceed summarily only by and with the consent of the proposed defendant.

It is of interest, too, that, apart from the instant case, the two latest pronouncements on the subject have come from the Eighth Circuit. In the case of *Gamble* v. *Daniel,* decided in 1930, 39 Fed. (2d) 447, at page 453, the court said: "If such possession be in the bankrupt, the court of bankruptcy has jurisdiction by summary proceedings to adjudicate the rights of the parties; while, if such possession be elsewhere, the adjudication must be by plenary suit in the proper federal or state court, if the claimant objects to a summary proceeding in the bankruptcy court. This rule has been so often announced that it is necessary to cite only the latest cases." See cases there cited.

In the case of *Page, Trustee,* v. *Arkansas National Gas Corporation* (C.C.A. 8, decided 1931), 53 Fed. (2d) 27, opinion by Circuit Judge Kenyon, at page 34: "The party claiming to hold adversely in the present case brought the action in intervention and consented thereby to the jurisdiction." Later, at page 35: "In 5 Remington on Bankruptcy, section 2195, page 280, it is said: 'Jurisdiction may be conferred on the bankruptcy court by the defendant's consent, in cases where otherwise it has no jurisdiction, and if adverse claimants in possession of the property who would otherwise not be within the jurisdiction of the bankruptcy court, nevertheless voluntarily surrender custody of the

property, or consent to the jurisdiction of the bankruptcy court, then the question of ownership, and all other questions in relation thereto, as, for instance, the extent, validity and priority of liens upon and interests in the property, may be tried out in the bankruptcy proceedings.'" The court also held, at page 36: "We are satisfied that the bankruptcy court had jurisdiction to try in a summary proceeding the question of title to the Bilyou lease raised by the Lyvers intervention on the grounds: (a) That it had possession in the sense of 'custodia legis' of the property involved, or (b) that Lyvers consented to its jurisdiction and did not object to the summary form of the proceeding until the referee had made his order."

From the foregoing it will appear that in the Page case consent was implied, while in the instant case express consent was given. A number of the District Courts have likewise held that jurisdiction in summary proceedings over adverse claimants can be acquired by consent.

In re Steuer (D.C. Mass.), 104 Fed. 976.
In re White Satin Mills (D.C. Minn.), 25 Fed. (2d) 313.

The principles hereinbefore enunciated are not to be confused with the unlawful premise that a trustee can implead, before a referee in bankruptcy, an adverse claimant without his consent. So far as the authorities holding that this cannot be lawfully done are, by obiter or otherwise, authorities for any other contention, then it is in support of the position here taken by the petitioner. See *Weidhorn* v. *Levy*, 253 U.S. 268. There a suit was brought, plenary in character, before a referee in bankruptcy for the purpose of setting aside a transfer of property as provided in section 70 (*e*). The respondent in the suit never consented to jurisdiction, nor had he in any wise invested jurisdiction in the court, but at all times objected to the latter's exercising jurisdiction over the case. In line with its earlier decisions, this

court there held that the trustee in bankruptcy could not, without the consent of the adverse claimant, implead him before a referee in bankruptcy.

There are many authoritative cases holding to like effect that substantial adverse claimants cannot, upon petition and without consent, be impleaded in a summary proceeding, but these cases are not here in point.

It will also be borne in mind that in the instant case the respondent not only appropriated the bankrupt's balance and certain deposits as previously stated, but, moreover, and immediately thereafter, obliged the bankrupt company to assign all its property to an officer of the respondent herein. As to the property so assigned, neither the respondent, nor its officers or the assignee, raised any question whatsoever about the summary jurisdiction of the court, but surrendered all such property or the proceeds thereof to the court. As to the bankrupt's balance and deposits that had been appropriated by it, the respondent set up claims of adverse ownership. As will be seen from the authorities hereinbefore cited, it is well within the power of the referee to determine whether the respondent's claims are merely colorable in character or, on the other hand, are made in good faith and are substantial.

Harrison, Trustee, v. *Chamberlain, supra.*

III. The merits of the case present a question of great public interest, and the supervision of this court should be exercised to the end that a rule of law applicable thereto may be established.

The question hereunder may be thus stated: May a bank or a trust company rightfully assert a banker's lien on funds received by it at a time when it is possessed of knowledge of its customer's insolvency and when it intends to appropriate such deposits as that customer might thereafter make with it?

Treating with the elements involved:

(A) *Insolvency.*

Hall, who was the assignee under the assignment for the benefit of creditors and an officer of the respondent herein, testified that the assets of the company had been sold by him for $14,330.01, which amount represented the fair value of all the assets of the company both as of the time of the assignment and of the time of the sale, and also as of the times of the said set-offs or appropriations, which were within four days of the assignment; and that the liabilities of the said company at such times and after the set-offs or appropriations as aforesaid were $58,016.36.

The president of the respondent testified that he regarded the company as insolvent (Rec. p. 88) as of said times; hence, upon the admission of the respondent, the company was insolvent as of the times complained of.

(B) *Reasonable cause to believe that preference would be created.*

There can be no controverted issue under this question, for the respondent, by one or more of its officers, who had charge of the transactions between it and the company, had knowledge of the insolvency of the company as of the times complained of and, therefore, not only had reasonable cause to believe, but actually knew, that the appropriations or set-offs made by it would operate to give it a larger percentage of its indebtedness than would be received by other creditors of the company of the same class.

The president of the respondent testified before the referee that he knew that it was futile even to ask the company for payment—he knew that the loan could not be paid without wiping out the business. He knew that to insist upon payment meant closing down the business (Rec. pp. 85, 88), and he also knew that the company was insolvent. Substantially

the same knowledge was possessed by Crocker, the vice-president. He knew the loan was a "frozen" one and could not be collected. Consequently, and in the light of the knowledge possessed by it, the respondent not only had reasonable cause to believe that the appropriations or set-offs made by it would operate to give it a larger percentage of its indebtedness than would be received by other creditors of the same class, but actually knew that such would be the result. One of the outstanding authorities governing this principle of law is the case of *Merrimack Nat. Bank* v. *Hollis R. Bailey et al.* (C.C.A. 1), 289 Fed. 468 (certiorari denied, 263 U.S. 704).

(C) *Were the collected funds on deposit with the appellant on July 12, 1929, subject to a lawful set-off or appropriation by the appellant?*

> "Bank creditors are subject to exactly the same rule of law as to preferences and set-offs as are merchandise and other creditors."
>
> *Merrimack Nat. Bank* v. *Hollis R. Bailey et al.* (C.C.A. 1), 289 Fed. 468, 470.

The collected funds of $4027.29 represented deposits made with the respondent by the company subsequent to the time of a certain stockholders' meeting held some three weeks prior to July 12, 1929, the date of the first appropriation or set-off.

The president of the respondent was the only creditor or representative of a creditor at that meeting. He was there asked to grant an extension of time for the payment of the indebtedness due to the bank. While it is true that the president in his own testimony states that he did not agree to grant the extension, yet by his words and conduct at such meeting he led some of those present to believe that, in behalf of the appellant, he was assenting to the request. Had he not so conducted himself, it stands to reason that the funds

of the company would not have been imperiled by further deposits in that bank. Besides, the president's course of conduct at such time in so falsely misleading the stockholders was quite in keeping with the course thereafter pursued by him and the respondent.

They knew that the company's principal customer paid its bills to the company around the middle of each month. On or about the 10th of the month following the stockholders' meeting, a notation was caused to be made on the ledger card, upon which was kept the company's account, directing that all deposits and checks drawn on the account should be shown to the vice-president. The respondent and its officers did not then reveal to the company and its officers its intentions and actions.

Later, and on July 12th, when the respondent had in its hands the expected funds, it promptly caused a set-off to be made of all the collected funds then in the account. Even then the company and its officers were kept in ignorance of the respondent's actions.

The first knowledge the company had of what the bank had done came on Monday, July 15, 1929.

Upon the facts it is evident that the deposits made from and after the time of the stockholders' meeting were not received by the respondent in the regular and usual course of dealings between it and the company.

The facts in the Bailey case are quite analogous to those here presented, save that in the former case a creditors' committee had been appointed, which fact was known to the bank, whereas in the instant case a meeting of stockholders had been called and held, and what transpired at that meeting was known to the bank.

The Merrimack Bank-Bailey case (*supra*) is authority for most of the petitioner's contentions. It establishes that a transfer and a set-off are one and the same, and are to be dealt with accordingly; that bank creditors are to be treated according to the same rule as are merchandise and other

creditors; that a bank having knowledge of insolvency is affected by the same rule as is any other creditor, and that after such knowledge there can be no "usual course of business."

At page 471, Mr. Justice Anderson, speaking for the court, said:

> ". . . if then the banks had had and had exercised the right of set-off claimed by the present appellant, substantially all of the assets would have been appropriated by the bank creditors, leaving nothing for the general merchandise creditors. A result more obnoxious to the principle of equality, which underlies the Bankruptcy Act, can hardly be imagined."

It is interesting to observe that in the instant case the bank did appropriate $20,476.79, leaving assets worth about $14,000 to be shared *pro rata* by the bank, upon the balance of its claim, with all other creditors—a result exceedingly "obnoxious to the principle of equality."

A State authority also in point is the case of *Putnam* v. *United States Trust Co.*, 223 Mass. 199, opinion by Mr. Chief Justice Rugg. This case holds, briefly, that a bank cannot set off deposits from and after acquiring knowledge of insolvency without creating a preference, and that there is no distinction between a payment and a set-off. This authority, like many others, distinguishes the Massey and Studley cases, hereinafter referred to, and clearly shows that those cases have no application to any phase of law here involved.

Upon the facts and the law, the appellee respectfully submits that the appellant did not have the lawful right on July 12, 1929, to set off the sum of $4027.29, and hence the same is recoverable by the appellee in this proceeding with interest.

(D) *Were the deposits of July 11, 1929, and July 15, 1929, respectively, made and received in the usual course of dealings between the parties?*

Deposits received by a bank after it has knowledge of the insolvency of the depositor, and with the intention of applying the same on account of the indebtedness due by such depositor to the bank, cannot lawfully be appropriated or set off, for that the same are not received in the ordinary and usual course of dealings between the parties; and any attempt on the part of the bank so to do constitutes an unlawful preference.

See *Mechanics' Bank* v. *Ernst*, 231 U.S. 60.
National City Bank v. *Hotchkiss*, 231 U.S. 50.
May v. *Henderson*, 268 U.S. 111.
Continental Nat. Bank v. *Moore* (C.C.A. 9), 299 Fed. 270 (certiorari denied, 266 U.S. 612).
First National Bank of El Centro v. *Harper* (C.C.A. 9), 254 Fed. 641.
Bank of Commerce and Trust Co. v. *Hatcher* (C.C.A. 4), 50 Fed. (2d) 719.
Gates v. *First Nat. Bank of Richmond*, 2 A.B.R. N.S. 507 (D.C.).
Re Fairburn Oil & Fertilizer Co., 240 Fed. 835.
Merrimack Nat. Bank v. *Bailey*, *supra*.
Putnam v. *United States Trust Co.*, *supra*.

The Hotchkiss and Ernst cases (opinions by Mr. Justice Holmes) are of peculiar interest:

In the Hotchkiss case, at page 58: "The bank did not confine its demands to proceeds of the loan, but asked for and obtained securities without regard to their source. It was notified in terms that it was receiving a preference and that the firm was going into bankruptcy. If this was not sufficient notice, it is hard to imagine what would be enough."

In the instant case the respondent herein did the planning for the liquidation, as well as the notifying.

In the Ernst case, at page 67: "The so-called deposit of $54,048.04 was paid in after the cashier had forbidden the payment of checks against the deposit account, and therefore rightly was held to be a payment and a preference. A set off was properly denied."

Here again the facts are somewhat analogous. Under the directions of the vice-president, no checks were paid, except a few small wage checks, and these were paid solely because counsel had said that they would have priority in the liquidation of the bankrupt's affairs. Even all checks of this character, which were presented, were not paid, for most of them were held up and subsequently turned over to the assignee for payment by him out of the funds coming into his possession.

The characterization of the deposits as "the so-called deposit" is particularly applicable to the facts in the case at bar, for, in truth, the moneys which the appellant bank received on July 11th and on July 15th did not assume the aspects of bona-fide deposits, due to the then intentions of the appellant and its officers.

The case of *Continental National Bank* v. *Moore, supra,* did not turn on any point involved in the instant case, yet the reasoning there employed clearly recognizes that, under facts such as here presented, a preference is created.

In the *First National Bank of El Centro* v. *Harper* the petitioner has an outstanding authority in support of his contentions. After distinguishing the facts there, which were analogous to the facts in the case at bar, from the Massey and Studley cases, hereinafter referred to, it held, in substance (p. 86): "That the monies so collected by the bank were deposits created otherwise than in the ordinary relation between a bank and its depositor." There was no fraud or collusion between the bank and its depositor. This case, therefore, clearly stresses the point that fraud or collusion between depositor and bank is not essential to defeat the right of set-off.

The case of *Bank of Commerce and Trust Company* v. *Hatcher, supra,* was decided but a few months ago. There the bankrupt, for whom Hatcher was trustee, had for some while been insolvent and such insolvency was known to the bank. The bankrupt company had undertaken the completion of a road contract which had been started by another. One of the conditions under which the contract was sublet to the bankrupt company by the original contractor was that the moneys received from the contract should be deposited with the appellant bank and that the sub-contractor, the bankrupt, should disburse such funds by checks bearing the signature of the bank's vice-president. At that time the bankrupt was owing the appellant bank a substantial sum of money. Its promises of payment had failed to materialize. On December 2d the bankrupt had no balance to its credit with the appellant. Later on that day, however, the bankrupt's bookkeeper deposited to his company's credit the sum of approximately $8000, received from this road contract, and at the same time submitted to the vice-president of the bank checks in like amount drawn to creditors. The vice-president refused to approve these creditor checks, but did receive the deposit and applied the same on account of the bank's claim. The question involved was whether the deposit was received in the usual course of business. Held, that it was not a deposit received in the usual course of business, but rather a recoverable preference.

In the Gates case (D.C. Va.) the District Judge, delivering his opinion from the bench, at page 511, said:

> "I asked him, myself, that question,—if the company were forced into bankruptcy would it be in a position to deny bankruptcy, by asserting solvency, and he said clearly he had no such idea, that the only way to save it was to keep out of bankruptcy, by the methods suggested."

Again, at page 513:

> "The company was not, it is true, being operated by its creditors' committee, therefore the deposits in the bank were made by the company itself, rather than as in the Merrimac case. But the deposits were after the suspension of operations, and the bank knew this. So I don't think the deposits were made in the ordinary course of business, but, if in due course, I think the bank knew of the practical impossibility of keeping it out of bankruptcy, which fact was well known to everybody. It seems to me, therefore, under the circumstances, that the trustees are entitled to judgment, and I think interest should run from the time the referee declared the first dividend. A decree will be entered accordingly."

Here again we have a case where the facts are quite analogous. The deposits were made by the company itself, and not by a committee. The bankrupt's course of conduct contemplated a suspension of operations. In our case not only did the bank know of the "practical impossibility of keeping it [the company] out of bankruptcy," but intended that an assignment or bankruptcy should occur.

The foregoing are the controlling cases. *New York County National Bank* v. *Massey*, 192 U.S. 138, is not an authority here in point. There it was not shown, as a fact, that the bank intended to apply the deposits until the application was actually made; hence it was held that the deposits were received in regular manner, and, therefore, permitted to be set off.

The case of *Studley* v. *Boylston National Bank*, 229 U.S. 523, is without any authoritative application here, for the reason that knowledge of insolvency, or reasonable cause to believe a preference was being created, was not shown. Besides, the set-off in question constituted the charging up of a note, which was a customary course of dealings between

the parties. Nor is the recent case of *Citizens Nat. Bank* v. *Lineberger,* 45 Fed. (2d) 522 (C.C.A. 4), in point; for there the bank, upon acquiring knowledge of insolvency, set off funds received prior thereto.

Conclusion.

The petitioner herein submits (*a*) that as to the respondent's present contention that the Bankruptcy Court was without jurisdiction, notwithstanding its expressed consent given thereto, such contention is lacking both in legal and moral foundation; and (*b*) that upon the facts of the case and the law applicable thereto, he is entitled to a judgment against the respondent in the sum of $20,476.79, with interest from the date of the filing of his original petition and with costs.

Respectfully submitted,

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